IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

SOUTHWEST REINSURE, INC.,

Plaintiff,

v. **Case No. 11-CV-000689 MCA/ACT**

SAFFA REINSURANCE CO., LTD.,
VEHICLE EXTENDED REINSURANCE CO., LTD.,
and BAKERSFIELD GROUP REINSURANCE CO., LTD.,

Defendants.

DEFENDANTS' RESPONSE IN OPPOSITION TO PLAINTIFF'S MOTION TO SANCTION DEFENDANTS FOR PARTICIPATING IN SETTLEMENT MEDIATION IN BAD FAITH

Defendants Saffa Reinsurance Co., Ltd. ("Saffa"), Vehicle Extended Reinsurance Co., Ltd. ("VERC") and Bakersfield Group Reinsurance Co., Ltd., ("Bakersfield"), by and through their attorney of record, Olsen, Parden & Crow, P.C. (Arlyn G. Crow, Esq.), hereby submit their Response in Opposition to Plaintiff's Motion to Sanction Defendants for Participating in Settlement Mediation in Bad Faith ("Response"). As grounds for their Response, Defendants state that Plaintiff's failure to provide documentation and support for their claimed damages during discovery- and during the mediation process- is the cause of the mediation's failure, not Defendants' failure to offer an amount to settle alleged damages that were never previously disclosed to Defendants.

Factual Background

Plaintiff and Defendants are in the Vehicle Service Contract industry. Vehicle Service Contracts ("VSCs"), which are more commonly referred to as "vehicle warranties" and "extended vehicle warranties," provide protection against unanticipated repair or auto part replacement costs for consumers beyond, or in addition to, factory warranties. These VSCs are usually marketed by warranty companies (commonly referred to in the industry as an "Administrator Obligor"), or their agents, to automobile dealerships as a vehicle warranty product to be sold to automobile purchasers.

In an Administrator Obligor program, the warranty companies develop programs that allow a Producer to realize back-end profits on the sale of the VSCs by creating a reinsurance company for the Automobile Dealer ("Producer"). The reinsurance company reinsures the VSC obligations of the Administrator Obligor. Generally, the Administrator Obligor enters into a relationship with the reinsurance company ("Producer Owned Reinsurance Company" or "PORC") whereby the Administrator Obligor cedes its vehicle service obligations to the PORC in exchange for the net premium (amount received from consumer less commissions and fees).

The PORC does not handle the premium. Instead, the PORC enters into a trust agreement with a bank and the Administrator Obligor. This trust agreement allows the Administrator Obligor, or its third-party administrator ("TPA"), to control the deposits and withdrawals from the trust account and to use the premium deposited into trust to pay claims and claims expenses brought against the VSCs. Once all claims have been paid and all contracts have expired, the PORC is entitled to the premium left in the account and any and all investment income that the trust funds may have earned ("Earned Premium Reserves").

What is critical to note about these VSC Programs is that there are numerous companies involved in providing- and insuring- the VSC product. Therefore, each company has different legal duties and responsibilities and any claimed damages will be wholly dependent upon the rights and responsibilities between the contracting parties. For example, a TPA in the VSC industry manages the relationship between the Producer, the Administrator Obligor, and the consumer of the VSC product. Thus, the TPA provides, among other things, premium collection, claims administration, trust management, and other functions, on behalf of the Administrator Obligor (or "AO"). In essence, the TPA performs and manages all of the contractual obligations of the Administrator Obligor that exist between the AO, the Producer, and the VSC consumer.

In this case, Plaintiff acted as a TPA for the Administrator Obligor (Century) on the VSCs reinsured by Defendants. Thus, Plaintiff handled the claims administration and claims payment brought against Century VSCs. Defendants, on the other hand, reinsured the obligations of Century; that is, Defendants agreed to indemnify the AO for claims and claims expenses brought against the AO, Century, by VSC consumers. Pursuant to the Reinsurance Agreement between the respective parties, Century would cede 100% of the net premium to the PORC designated by the Producer to reinsure the ceded obligations. In exchange for the net premium, the PORC would indemnify Century for any claims or claims expenses brought against Century. As such, each respective PORC is liable to the Obligor, in this case Century, for claims and claims expenses. Plaintiff was not a party to this Reinsurance Agreement between Century and the PORCs.

Besides performing the TPA function for Century, Plaintiff also provided limited management functions for the Defendants. The services provided the PORCs are separate and fundamentally different from the TPA's roles for the Administrator Obligor described above. For example, in this case, Defendants Saffa, VERC and Bakersfield had a management agreement with Plaintiff whereby Plaintiff would provide advice to the Defendants related to reinsurance practices in the industry, prepare any reports required for the operation of the PORC; and manage any regulatory aspects for the PORC. At no time did Plaintiff pay claims or perform any other function for the benefit of the reinsurance company. Moreover, Plaintiff was not a party to any other agreement with the Defendants.

As already stated, a determination of who owes any alleged Amount Due is wholly dependent upon a determination as to the roles each entity played in providing the VSC services and of the legal and contractual relationships between the parties. Plaintiff, in its Complaint, seeks to recover certain amounts alleged due by each Defendant under a theory of unjust enrichment and a claim for restitution. Specifically, Plaintiff alleges that "[w]ithout any legal obligation to do so, and for the sole benefit of Saffa, Plaintiff paid $172,164.84 of Saffa's obligations under the Saffa Reinsurance Agreements." (Doc. 22 at ¶ 12). Plaintiff has made similar allegations against Defendant VERC, alleging that it paid $326,826.56 of VERC's obligations under the VERC Reinsurance Agreement (Doc. 22 at ¶ 26), and against Defendant Bakersfield, alleging that it paid $30,418.69 of Bakersfield's obligations under the Bakersfield Reinsurance Agreement (Doc. 22 at ¶ 38).

Procedural Background and Discovery Issues

Although Plaintiff alleges that Defendants owe it a sum of approximately $530,000.00, Plaintiff has been slow to produce the documents that support its claims for these damages. First, Plaintiff failed to provide the type or category of damages, or any documents to support its claimed damages, in its initial disclosures. (*See* Declaration of Arlyn G. Crow, attached hereto as Exhibit A, at ¶ 3 and Exhibit 1, attached to the Declaration). In order to flesh out Plaintiff's claimed damages, Defendants then served discovery on Plaintiff, seeking to understand the category or types of damages claimed by Plaintiff, when the Amount Due was created, and how or why the Amount Due is owed by Defendants. (*See* Ex. A, Decl. A. Crow, at ¶ 4). In its supplemental response to Defendants' written discovery requests, Plaintiff claimed that it was entitled to a "producer accounts receivable." (Ex. A, Decl. A. Crow, at ¶ 3). In other words, Plaintiff alleged that it would receive premium from a producer and sometimes that premium would be under-remitted, or not enough, to cover the cost of the VSCs. (Ex. A, Decl. A Crow, at ¶ 4, Ex. 2, 2a, 2b) ("for accounts receivable, Plaintiff creates a batch for each submission of business received from each receiver. . . . Plaintiff then mails a "Business Confirmation/ Invoices per batch to producers monthly for the business closed the month. . . . If there is an amount due for that batch, then the producer is to remit that amount along with the next submission of business."); (Ex. A, Decl. A. Crow, at ¶ 9, Ex. 3) Although Defendants specifically sought information regarding Plaintiff's claimed damages, Plaintiff repeatedly failed to articulate the basis for its claimed damages. (Ex. A, Decl. A. Crow, at ¶ 20). Based on the discovery responses provided by Plaintiff, as well deposition testimony, Defendants understood Plaintiff to be alleging damages based on the uncollected premiums, or "Producer Receivable." (Ex. A, Decl. A. Crow, at ¶¶ 10-20; Declaration of Elias "Chuck" Haddad, attached hereto as Exhibit C, at ¶¶ 8, 11, and 12; Declaration of Reza Bashirtash, attached hereto as Exhibit B, at ¶¶ 8, 11, and 12). There was certainly no information provided to Defendants that indicated that there were additional damages or additional support for the alleged damages.

Because the discovery disclosed that Plaintiff sought a Producer Receivable, or uncollected premium, from the Producer/Dealer, and because the PORCs reinsured the obligations of the Obligor- and nothing else-it was Defendants' position that a different entity would owe such alleged amounts- not Defendants. Thus, it was Defendants' position after discovery that Plaintiff were seeking to collect a producer balance from the wrong entities.

Mediation Conferences

The initial mediation conference was scheduled for April 24, 2012. Defendant Saffa attended this mediation conference through its authorized representative. (Ex. B, Decl. R. Bashirtash, at ¶¶2, 3). Defendants Bakersfield and VERC also attended this conference through their authorized representative, Mr. E. Haddad. (Ex. C, Decl. E. Haddad, at ¶¶2, 3). Mr. Haddad and Mr. Bashirtash flew in from Bakersfield, California to attend the mediation. Defendants' undersigned counsel prepared a position statement for the mediation.

During the first mediation on April 24, 2012, Plaintiff, *for the first time*, claimed that it was entitled to money from Defendants because the Reserve trust Accounts were overfunded and these funds deposited into the Defendants' respective reinsurance account. This claim of "overfunding" came a mere six (6) days prior to the close of discovery. The alleged "overfunding" claim was different from the Producer Receivable claim because now Plaintiff was alleging that it transferred too much money out of the Reserve Trust Account and into the PORC's discretionary reinsurance account instead of the original producer receivable claim that Plaintiff essentially paid reinsurance premium on behalf of the AO. However, in attempt to continue settlement discussions, Defendants and their undersigned counsel agreed to review *all* of the documents that Plaintiff asserted would support its claimed damages. (Ex. A, Decl. A. Crow at ¶12; *See also* Doc. 33-7, Email from P. Fish to A. Crow and D. Thuma on April 24, 2012). Thus, in an attempt to salvage the mediation conference, it was continued until May 30, 2012.

On May 10, 2012, the undersigned counsel traveled to Plaintiff's office located in Albuquerque, New Mexico to review documents to support Plaintiff's claimed damages. When defense counsel arrived, Plaintiff revealed that there were hundreds of boxes that contain source documents on claims and producer receivable information. (Ex. A, Decl. A. Crow, at ¶ 13). Faced with the voluminous documents, the undersigned counsel requested a spreadsheet or summary of the claimed damages so that he could determine which source documents, if any, he would need to review prior to the second mediation. (Ex. A, Decl. A. Crow, at ¶ 13 and Ex. 5, attached to Decl.). Plaintiff, in response to Defendants' request, provided a producer receivable summary on May 14, 2012. (Ex. A, Decl. A. Crow at ¶ 16 and Ex. 7, attached to Decl.). On May 10, 2012, Plaintiff had also provided information related to transfer of funds in and out of the reserve trust accounts that were used to pay claims to allegedly show that the Reserve account was overfunded and that the funds were transferred to the respective PORC's discretionary account. (Ex. A, Decl. A. Crow at ¶ 14 and Ex. 6, attached to the Decl.). Again, it was Defendants' understanding, based on the responses from Plaintiff throughout the discovery and mediation process, that the only damages claimed by Plaintiff were related to a Producer Receivable and an alleged over-funding of the Trust Account. (Ex. B, Decl. R. Bashirtash, at ¶ 7; Ex. C, Decl. E. Haddad, at ¶ 7). Based on their understanding of Plaintiff's claimed damages, Defendants were prepared to continue with mediation discussions.

In preparation for the May 30, 2012, the undersigned counsel prepared a second confidential mediation position statement and again, Mr. E. Haddad and Mr. R. Bashirtash traveled from Bakersfield, California to attend the conference. On May 30, 2012, when the parties reconvened for the second mediation conference, Plaintiff not only claimed that it was entitled to Producer Balances and over-funding of the trust account, but also claimed that it was entitled to claims and claims expenses for all, or a portion, of 2006. (Ex. A, Decl. A. Crow, at ¶ 19; Ex. B, Decl. R. Bashirtash, at ¶¶ 9-10; Ex. C, Decl. E. Haddad, at ¶¶ 9-10). In support of these claimed damages, Plaintiff provided to the Defendants at the mediation a spreadsheet of claim expenses allegedly paid by Plaintiff on behalf of each Defendant. (Ex. A, Decl. A. Crow, at ¶19 and Ex. 8, attached to the Decl.). Neither Defendants, nor their counsel, had seen this document prior to the mediation. (Ex. A, Decl. A. Crow, at ¶ 20; Ex. B, Decl. R. Bashirtash at ¶ 10; Ex. C, Decl. E. Haddad, at ¶ 10).

It is critical to note that Plaintiff, as TPA for Century, would have paid claims and claims expenses on behalf of Century. Thus, this claimed damage raises fundamentally different legal and factual issues than those claimed damages previously alleged. Therefore, because Defendants had not had the opportunity to assess these new claimed damages, they felt they did not have the authority to settle a claim for these newly claimed damages without an opportunity to determine, legally and factually, whether Defendants actually owed the claimed amounts and whether the other owners of the PORCs would agree to a settlement of such claimed amounts. (Ex. B, Decl. R. Bashirtash at ¶ 11); Ex. C, Decl. E. Haddad, at ¶ 11). Though the Defendants attended the conference to discuss and mediate the dispute regarding the accounts receivable and the overfunding of the trust account, the Defendants were wholly unprepared to discuss or mediate a dispute over claims paid because those alleged damages had never been disclosed and had not been analyzed.

Notwithstanding Plaintiff's failure to disclose its claimed damages, Defendants did not leave the settlement conference- nor did they ever assert that they were unwilling to engage in-settlement discussions. (Ex. B, Decl. R. Bashirtash, at ¶ 8; Ex. C, Decl. E. Haddad, at ¶ 9). It was Defendants' understanding that Plaintiff and its counsel left the mediation prior to Defendants. (Ex. B, Decl. R. Bashirtash, at ¶ 12; Ex. C, Decl. E. Haddad, at ¶ 13).[1]

[1] Because of the confidential nature of the mediation, Defendants are not divulging any offers or demands, if any, made between the parties to this case, or similar confidential information.

Contrary to Plaintiff's position, Defendants did not attend the mediation in "bad faith." The Defendants expended time and resources to educate themselves on the claimed damages and spent time and resources on preparing for, and attending, a mediation in Albuquerque, New Mexico. The failure of the mediation is directly attributable to Plaintiff's failure to properly disclose its claimed damages during discovery, and during the mediation process, and its failure to fully understand its legal and factual claims. This is evidenced by its recent request to amend its complaint to identify new parties to the litigation and to assert various claimed damages. (*See* Doc. No 43.)

Argument and Authorities

Although it is not clear from Plaintiff's motion, Plaintiff appears to be seeking sanctions against Defendants under Federal Rules of Civil Procedure 16 (f) (1) (B). Rule 16 (f) (1) (B) allows the court to issue "any just orders . . . if a party . . . is substantially unprepared to participate – or does not participate in good faith – in the conference." Defendants dispute that they did not participate in good faith in the two settlement conferences. Despite Plaintiff's unsupported assertions,[2] Defendants did have settlement authority to settle those types of damages disclosed during discovery and at the first mediation. Defendants, however, were surprised and upset by the belated disclosure by Plaintiffs of a new category of damages: claims paid. It was these newly disclosed damages that hampered settlement discussions- not any failure on the part of the Defendants.

Implicit in Plaintiff's argument is that Defendants should be required to settle a matter, even though they do not have an opportunity to review or analyze these newly claimed damages. Defendants, however, should not be forced to settle a case when they have taken diligent steps to

[2] Surprisingly, Plaintiff does not provide any factual support for its claims that Defendants acted in bad faith during the settlement conferences. Argument of counsel should not be allowed to provide factual support for a motion for sanctions.

discover a Plaintiff's claimed liability and damages, but are confronted with new damages at a court-ordered settlement conference. *See Easterbrook v. Life Ins. Co.*, No. CV-06-956 PHX/MHM (D. Az. 2007), 2007 U.S. Dist. LEXIS 17990 (D. Ariz. 2007) ("full and complete authority . . . means that the individual appearing for, or on behalf of, the Defendants, shall have the express authority and discretion to authorize payment to, or accept the terms of, Plaintiff's last settlement demand. . . .[It] does not mean, however, that Defendant or representative is required to pay such demand or any sum whatsoever."); *Kothe v. Smith*, 771 F.2d 667, 669 (2d. Cir. 1985) (Rule 16 "was not designed as a means to for clubbing the parties – or one of them, into an involuntary compromise."). If that were allowed, a Plaintiff could fail to provide full disclosure of their case and then force Defendants to settle, without adequate time to review or analyze the alleged claims, because of Defendant's fear that they would be sanctioned for refusing to settle such claimed damages. This Court should not allow such tactics.

As the discussion of the timeline of discovery and factual background of the present matter indicates, Defendants have been ambushed by a different basis for the amount due at each of the settlement conferences. Although Plaintiff has accused Defendants of improperly attempting to use the mediation conferences as a discovery tool, that simply does not make sense in the context of the factual discussion and timeline of the case presented above.[3] Just because the parties were unable to come to compromise, does not mean that Defendants failed to participate in good faith in the settlement discussions; especially when the Defendants were never advised of all of Plaintiff's alleged damages prior to the mediation and when they asked for full disclosure of such damages. *See, e.g., Kothe v. Smith*, 771 F.2d 667, 669 (2d. Cir. 1985)

[3] According to Plaintiff, Defendants "stated or implied that they had intended the mediation . . . to obtain additional discovery." (Doc. 37 at ¶ 11). It is not clear to Defendants how Plaintiff came to this understanding and the assertion seems rather absurd when this Court considers that the Court had granted Defendants' Motion to Extend Discovery (Doc. 34, entered on May 29, 2012). Furthermore, Defendants had conducted discovery on the issues that Plaintiff had identified in its Complaint and its responses to written discovery.

(Rule 16 "was not designed as a means to for clubbing the parties – or one of them, into an involuntary compromise."). For the foregoing reasons, Defendants respectfully request that this Court deny Plaintiff's Motion.

Conclusion

Defendants came to the bargaining table prepared to discuss their position on liability, on the issue of producer receivables, and on the claimed overfunding of the Reserve Trust Account. Defendants were reasonably upset when new claims for damages were brought to Defendants' attention, for the first time, at both of the mediation conferences. Defendants sent individuals who had authority to settle the case, but these individuals could not, in good faith, settle a claim when they simply did not know the basis for these newly claimed damages and did not have an opportunity to determine the merits of such a claim. For these reasons, Defendants request that this Court deny Plaintiff its Motion for Sanctions and award Defendants' their attorney's fees and costs in responding to the Motion, and for any other relief this Court deems just and proper.

Respectfully submitted,

OLSEN, PARDEN & CROW, P.C.

By: /s/Arlyn G. Crow

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I hereby certify that on this 20th day of June, 2012, the foregoing was electronically served on:

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